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An American Viewpoint

World Economic Crisis in the 1980s?

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Following is an address by Richard N. Cooper, Under Secretary for Economic Affairs, before the Alpbach European Forum in Alpbach, Austria, September 1, 1980.

My assignment is to give an American perspective on the world economy in the 1980s. I will begin with two caveats. First, it is always difficult to foresee a decade ahead. One thing we can be sure of: Any current forecast will be wrong, partly because new and unforeseen developments intervene, and even more because our collective behavior will be influenced by the forecast and our reactions to unwanted outcomes will negate the forecast. Second, the United States is an extremely diverse, pluralistic society, so there is no such thing as a single American view. Rather, we have a cacaphony of views, even—some foreigners observe critically—from government officials. What I offer is therefore one American view, although I know it is shared by many other Americans.

I will answer the question in the title in the affirmative: I do see economic crisis in the 1980s unless we act decisively to avert it. I see economic events in the 1980s driven largely by two factors—rapid growth of world population and inadequate supplies of oil at existing prices. Many other developments flow from these two factors. Rapid urbanization, congestion, famine, deforestation, severe competition for water, large-scale migration, urgent calls for more foreign aid—all these and more will flow from vastly increased population, unless we do something about it. Inflation, economic stagnation, higher unemployment, imbalances in international payments and instability in exchanges rates—all these and more will flow from the shortage of oil, again, unless we do something about it. I will focus my remarks first on population growth and then on energy.

Population Growth

On current projections, as reported in a recent U.S. Government study, *The Global 2000 Report,* world population in 1990 will be 5.3 billion, nearly 1 billion in excess of what it is now, reflecting a growth equivalent to nearly half the total world population when I was born. Even at that time, some political leaders were complaining of congestion and calling for more *lebensraum.* This increase, 90% of which will occur in developing countries, is truly staggering. We may be tempted to respond: out of sight, out of mind. And if the developing countries have their way with a new world information order, they may contribute to that temptation, as when, due to concealment, we failed to appreciate the full gravity of the Ethiopian famine several years ago until it was too late to save thousands of people. But, more likely, this vast population growth will impinge on us in a variety of ways—some direct, some indirect, none fully predictable.

First of all, there will be population pressure against agricultural land. This will lead to domestic and international conflict such as caused the Central American football war more than a decade ago. This pressure against land will also lead to deforestation—forests are even today being eliminated annually at the rate of 18–20 million hectares, roughly one-third the size of France—which, in turn, will lead to floods, loss of soil, reduced rainfall, and loss of biological species. (An estimated 500,000–1,000,000 species will be driven to extinction by 2000, with possibly important loss of genetic material. The losses will be predominantly in the wet tropics.)

Second, increased population growth will lead to greater urbanization and human congestion, which, in turn, will lead to political unrest, open conflict, greater terrorism, and possibly localized anarchy within many countries. (By the year 2000 ten cities in developing countries are expected to exceed 15 million people, with Mexico City leading the way at 30 million on current projections.)

Third, increased population will lead to vast increases in demand for food and paid employment to sustain life. On current projections, there will have to be over 300 million more jobs by 1990—three times the current U.S. labor force—and 750 million more jobs by the year 2000. Food imports by developing countries will rise sharply and so must their exports of manufactured goods in order to pay for food and energy. There will also be periodic famine and increased calls—some plaintive, some threatening—for much greater economic assistance, especially to pay for food. Demand for oil by developing countries will rise to fuel growing industry, to substitute for the declining availability of wood, and to intensify agricultural production, especially through increased use of fertilizers.

Finally, increased population will lead to increased international migration, partly as political refugees escaping from anarchy or terrorism or repressive governmental reaction to both of those, partly as economic refugees seeking to better conditions of life, just as Europeans moved to America in the last century. There will also be international appeals, both for financial assistance to refugees and for provision of places for permanent settlement. (There are already several million international refugees today.)

Can anything be done about population growth, or should we simply turn a deaf ear and put up the barricades?

Turning a deaf ear is not possible because of humane sentiments within our own societies. Fortunately, there is something we can do, both about population growth and about food production. The rate of population growth has been falling slowly but surely in developing countries. This decline in fertility is attributable, in part, to active family planning programs in many countries. Much more can be done. Family planning accounts at present for only 2% of foreign economic assistance. These sums could be effectively doubled and could be increased further during the course of the decade.

With actions that can be taken between now and the end of the century, it is estimated that world population could be reduced from a projected 6.3 billion people to 5.9 billion people. We will still be faced with substantial population growth, but it will be consequentially reduced. Moreover, the impact cumulates over time. Because of the momentum built into population growth, it takes several generations for stable conditions to be established throughout the population, even after the birth rate has been reduced to a level that permits long-run stability. Thus, the difference between 6.3 billion and 5.9 billion in the year 2000 generates a difference of over 2 billion people by the year 2100, assuming that the underlying conditions for population stability (i.e., each woman has only two children on average) has been established by the year 2000.

Beyond extension of existing programs and dissemination of existing techniques, we can productively spend more money on fertility research, especially in the area of temporary and reversible sterilization.

It is important to note that population control is not these days an issue of North-South contention. Increasingly, developing countries recognize that population growth is a powerful drag on their economic development. Government leaders from many countries—Bangladesh, Indonesia, Kenya, Morocco, to name only a few—have made strong statements supporting the need for population control. And other governments, where the issue is still somewhat sensitive, have nonetheless mounted effective family planning programs. Moreover, strongly supportive language can be found in numerous international resolutions, most recently from the U.N. Conference on Women at Copenhagen.

Even with larger efforts on this front, population growth will necessarily remain substantial. We therefore also need to support programs to increase food production. Projections in *The Global 2000 Report* suggest that grain imports by food-importing developing countries will grow from a level of 45 million tons in 1973–75 to 90 million tons by the year 2000 and that the real price of food will rise 45%–90% during this period. This last figure, of course, has a direct bearing on our own economies and our ability to contain inflation. Growth in food production will diminish pressure on food markets. The 1974 World Food Conference target of a 4% per annum increase in food production in developing countries was not achieved in the late 1970s. But it could be achieved during the 1980s. There is much more room for intensive production—some through small-scale programs involving information on new agricultural techniques, new seeds, and the use of fertilizers, combined with modest amounts of agricultural credits; some through large-scale, often multinational projects entailing control and distribution of water, as in northern India and western Africa. Large water projects have the not incidental advantage of generating substantial amounts of hydro-electric power, thus helping to alleviate the world oil shortage. (Harnessing the water running off the southern slopes of the Himalayas alone is estimated to be capable of generating as much hydro-electric power as there is in all of North America.)

Finally, some of the remaining increased food imports will necessarily have to be on concessional terms. For a start, we should strive to meet the agreed World Food Council target of 10 million tons of grain a year in food aid, perhaps conditioning some of it on improvements in indigenous agricultural programs. But over time the target will undoubtedly have to be enlarged.

Oil Scarcity

In turn now from the problem of population growth to the problem of oil scarcity. On past trends, but allowing for price increases that took place in 1979, projections of demand for oil over the next decade suggest that by 1990 the industrialized countries will import about 27–28 million barrels a day to meet this demand. Oil supply to satisfy this demand, in contrast, is likely to amount to only 21 or 22 million barrels a day. These projections, of course, involve many assumptions, which we can be confident will not be realized. They show an emergent "shortage" of oil at existing prices. The one thing we can all be sure of is that we will not consume more oil than is available. The question is not whether these projections will become true, but rather what adjustments will take place to eliminate the projected shortfall between supply and demand.

The adjustment can take place through higher prices for oil, through lower economic growth in consuming nations, or through conscious action by governments and citizens to reduce their demand for imported oil—or, of course, some combination of all these. But, if we do not rely on the third possibility, we will find that inflation is aggravated in all our countries. For each 10% increase in oil prices, the general price level is raised an estimated 0.3% in the first year and 0.8% after 4 years in the OECD (Organization for Economic Cooperation and Development) countries. And in the absence of conscious action to reduce demand for imported oil, economic growth will be slowed both directly—growth rates are reduced by 0.25% for every 10% price increase in oil—and indirectly, because of restrictive monetary and fiscal policies governments pursue in their struggle against inflation. Unemployment will grow and remain higher under these circumstances.

Indeed, economic policymakers in industrialized countries, taken together, face an acute dilemma. If our policy actions are keyed to maintaining moderate growth and employment, we will put pressure on the world oil market that will force us to trim back. But that, in turn, leads to what may become politically unacceptable levels of unemployment. Active energy policy is thus a necessary concomitant to growth policy. We need an active energy policy in order to preserve our economic growth and employment and to bring inflation under control.

In addition to these domestic impacts, failure to pursue an active energy policy will lead to imbalances in payments and to pressure on exchange markets as countries respond differentially to oil price increases. It will lead also to further borrowing by developing countries on top of an already large external debt, bringing ever nearer the possibility of a major default, which would have major reverberations throughout the international financial system.

These problems all arise if world shortage of oil emerges gradually and without surprise. In addition, we face the possibility of a sudden disruption in oil supplies, either as a conscious political act or as a result of social turmoil. A sudden disruption would lead to all of the problems mentioned above, but the impact could be even more severe. A large disruption could cripple our industrial activity and transport. I can think of no other area that represents such a profound threat to the cohesion of Western countries as friends and allies and to the very viability of our economic system.

Of course, we have not simply sat by and done nothing in the face of these possibilities and projections. To guard against disruption, we have created in the International Energy Agency (IEA) an emergency-sharing system whereby oil will be allocated among countries in accordance with an agreed formula for any disruption in oil supplies in excess of 7%. We have also committed ourselves in the IEA to hold oil stocks equivalent to at least 90 days of imports. These stock levels were reached in some countries for the first time, ironically, after the disruption of production in Iran and the competitive scramble for oil during 1979. The United States is building a strategic reserve of oil, and other countries also have government stock programs.

To address the longer term scarcity of oil, the IEA has established a system of national ceilings in the framework of an aggregate import target, along with a system for monitoring national performance in relation to the ceilings. The IEA targets, if achieved, would eliminate the projected oil imbalance over the next decade.

A substantial adjustment to emerging oil shortage has already taken place in all industrialized countries. The United States, in particular, now has in place an impressive and comprehensive program to conserve energy, to encourage the substitution of other fuels for oil, and to increase oil production in the United States. The traditional one-to-one relationship between growth of gross domestic product and growth of demand for energy has been substantially reduced over the last several years in all industrial countries. But some of the adjustment that has taken place has been induced by higher-than-necessary prices and some has been induced by lower-than-desirable growth.

I do not want to suggest that higher oil prices than those that prevailed before 1974 are not a necessary part of our oil conservation efforts. They clearly are, and our consumers should pay the full cost of oil. High oil prices are a necessary part of the solution to the emerging shortage, but ever higher prices are also part of the problem. Oil is not your normal run-of-the-mill commodity. Consumption of oil is sufficiently great, and demand for oil is sufficiently insensitive to price increases in the short run, that sharp price increases have substantial macroeconomic effects, raising inflation and retarding growth.

Rapid increases in oil prices place economic policymakers in each of our countries in an impossible dilemma. In our modern economies wage earners call for increased wages to cover price increases coming from any quarter. They do no distinguish between price increases originating outside the country—a loss of real income to the country as a whole—and those originating inside. Policymakers can either sanction the higher oil prices, along with the induced wage increases, thereby encouraging inflation. Or they can resist this pass-through of oil price increases, thereby generating economic recession.

Oil price increases also create exceptionally acute problems for developing countries. Scarce foreign exchange, crucial for capital investment needed for development, must be diverted into higher oil payments. In 1973, for example, Brazil paid the equivalent of 12% of its export earnings for oil, and India paid 22% of its export earnings for oil. The corresponding figures for 1980 are estimated at 50% for Brazil and 60% for India.

Clearly, we should seek measures that mitigate these dilemmas for both developed and developing countries. Domestic energy programs in the industrialized countries are necessary to accomplish this. In addition, actions by the developed countries to help augment alternative sources of energy in developing countries are in our own interests as well.

For these reasons, it is not appropriate to leave oil conservation entirely to "market forces." Private consumers of oil are guided in their decisions by present and future expected prices of oil. In their purchasing decisions they do not take into account the domestic and international macroeconomic costs associated with rapidly increasing oil prices.

There are two other costs not adequately taken into account by private decisionmakers. First, they do not take into account the total incremental cost to a nation arising from an increase in demand for oil. An increase in demand from a large country or by the industrialized countries as a group will increase the total bill for oil by driving up prices on all oil, as it did in 1979. The true cost to consumers of an incremental barrel of imported oil may be as much as twice its apparent cost, because it drives up oil prices.

Second, private consumers do not take adequately into account the risks of disruption. Private holders of oil ran down their stocks in 1978 when they could have built them cheaply and easily, but built up their stocks in 1979, thereby aggravating the oil shortage and driving the price of oil much higher than it need have been. And, of course, private consumers of oil give no concern in their purchasing decisions to national security or foreign policy considerations.

I sum up this discussion by arguing that the price mechanism must be supplemented—not replaced, but supplemented—by governmental action and guidelines encouraging or requiring conservation of oil. These actions are designed to protect the smooth functioning of our national economies. It is not sufficient to rely exclusively on the price mechanism.

I want, in concluding, to express doubts about another possible "solution" to the world oil problem. That is the suggestion that if we could only negotiate an agreement with the members of the Organization of Oil Exporting Countries (OPEC) over the price and supply of oil, we could restore some order to the world economy and then carry on with our national economic policies in confidence that they would not be disturbed by the oil sector in the ways that I have outlined above. This proposal presupposes, of course, that such an agreement could be negotiated with the OPEC countries at an acceptable cost. I want to raise a doubt whether such an agreement, assuming it could be negotiated, would in fact provide the security that its advocates claim for it.

We have now lived through a revolution in Iran, before 1979 the world's second largest oil-exporting country. Is there a credible agreement among nations that would insure us against a repetition of those events sometime during the next decade? And if there is not, should we not pursue policies which guard us against disruption of oil supplies, even if we did have such an agreement? We must, of course, engage in active and constructive dialogue with the oil-exporting countries. There are many interests we have in common, and we especially have in common the joint task of managing our actions so as to minimize disruption to the world economy. But I believe that we must rely principally on our own efforts to relieve the emerging shortage of oil in the coming years and to protect ourselves against sudden disruption of supplies.

Let me try to recapitulate. We should not be lulled into a false sense of security by the low year-to-year visability of population growth or by the present surplus of world oil supplies. Many other problems that we face—inflation, slow growth, higher unemployment, protectionism stemming from greater competiton from developing countries, degradation of the environment, even political unrest and terrorism—either stem from or are greatly aggravated by these two underlying factors. I have suggested, however, that there are actions we can take to deal with these basic underlying problems. If we wish to avoid economic crisis in the 1980s, we must push ahead with the important tasks of limiting population growth, augmenting food production, and reducing our demand for imported oil. ■

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